Brompton Insights

Investment Solutions for Market Uncertainty

February 2023

Funds in focus: Brompton Global Dividend Growth ETF (BDIV), Brompton Enhanced Multi-Asset Income ETF (BMAX), Brompton European Dividend Growth ETF (EDGF), Brompton Global Healthcare Income & Growth ETF (HIG), Dividend Growth Split Corp. (DGS, DGS.PR.A), Global Dividend Growth Split Corp. (GDV, GDV.PR.A)

2022 was one of the worst years on record for investment performance, with significant drawdowns for both equity and fixed income investors. The combined impacts of the Russia/Ukraine military conflict in Europe; continuation of Covid lock-down restrictions in China, the 2nd largest economy in the world; and to top it off, high inflation due to supply chain disruptions and the aggressive response from central banks, all set the stage for negative performance in 2022.

As discussed in the recent Brompton 2023 Market Outlook, our portfolio management team believes 2023 may be another challenging year, especially in the first half as the market continues to price in recession scenarios. While inflation has begun to decelerate, it remains elevated and there is still some uncertainty on the deceleration path. Central banks in both Canada and U.S. may continue their restrictive monetary policy with further interest rate hikes. The speed at which Central Banks have increased interest rates has caused some concern that tightening has gone too far, potentially pushing the economy into a recession.

In this article, we discuss several strategies that may help investors navigate today's market uncertainties.

Stay Invested

Whether or not global economies enter a recession in 2023, in our view, now is not the time to sell investments. When a recession begins, it's usually too late to benefit by selling stocks and bonds – the drawdown in equity or fixed income prices have typically already happened by the time investors read about it in the newspaper.

Recessions in the past have always been temporary, and investment performance tends to be strong off recessionary lows. The average length of recessions in the U.S. since WWII has been around 11 months, and the 2008 Financial Recession was the longest, with a duration of 18 months.

Investors should avoid panic selling and stay invested throughout the recession phase in order to benefit from market recovery opportunities. According to J.P. Morgan, the 10 best investment days over the 20 years ending in 2021 occurred after big declines of the 2008 financial crisis and the 2020 pullback during the onset of the Covid-19 pandemic. Attempting to time the equity market by selling can lead to investors missing out on meaningful positive investment performance.[1]

Growth of $10,000 from January 1, 2002 to December 31, 2021

Source: CNBC & J.P. Morgan Asset Management analysis using data from Bloomberg. Returns are based on the S&P 500 Total Return, best days are those with the highest daily returns between Jan 1, 2002 and Dec 31, 2021. https://www.cnbc.com/2022/03/09/you-may-miss-the-markets-best-days-if-you-sell-amid-high-volatility.html

Investment Strategies for Market Uncertainty

If you've made up your mind to stay invested, the next question is: what do I invest in? We have several suggestions for positioning your portfolio in a recessionary environment.

High Quality Dividend Growth Stocks

Dividend growth stocks tend to have competitive advantages and are leaders in their respective industry. The majority of dividend growth stocks have wide economic moats and healthy balance sheets; these companies can grow their profits during a strong economy while remaining resilient during recessions. The cash-rich nature of dividend growth stocks provide investors with strong downside protection during down markets and reliable dividend payments regardless of economic conditions.

Since 2000, dividend growers have consistently outperformed the broader market in down market years:

Down Years (2000 to 2022)	2022	2018	2008	2002	2001	2000
S&P 500 Dividend Aristocrats Total Return Index	-6.2	-2.7%	-21.9%	-9.9%	10.8%	10.1%
S&P 500 Total Return Index	-18.1	-4.4%	-37.0%	-22.1%	-11.9%	-9.1%
Dividend Growth Outperformance	+11.9	+1.7%	+15.1%	+12.2%	+22.7%	+19.2%

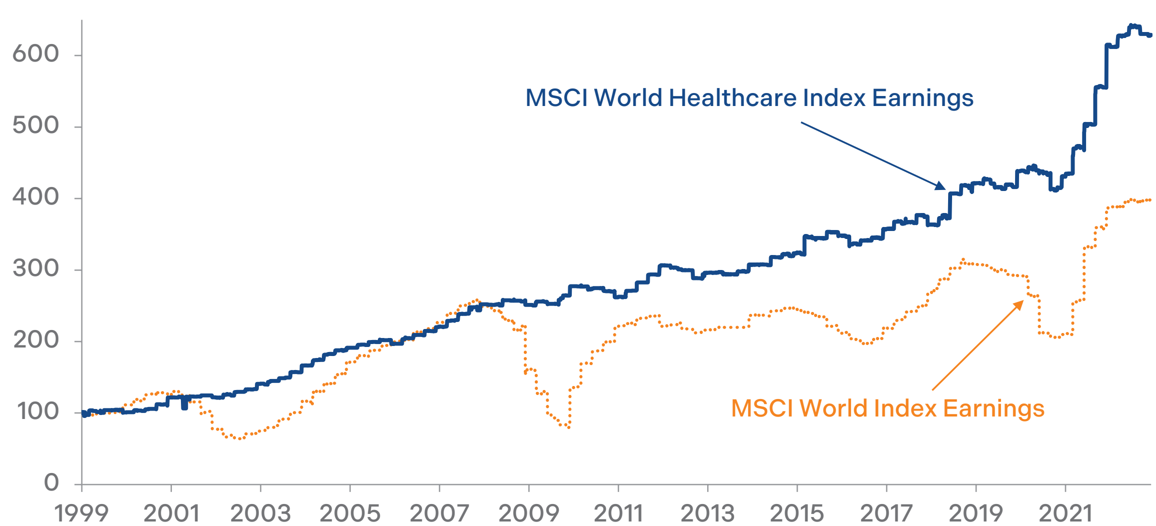
Source: Morningstar, January 1, 2000 to December 31, 2022

Healthcare Equities

The healthcare sector provides both stable dividends and defensive characteristics. Demand for healthcare services will always occur and tends to increase as the population ages, and people are enjoying longer lifespans. Many large cap healthcare stocks can generate durable cash flows due to their diverse product offerings, and can be profitable even during recessionary periods. These are attractive defensive investment characteristics.

Healthcare Companies have delivered over 20+ years of steady earnings growth relative to broad markets.

Stable Earnings Growth Across Cycles

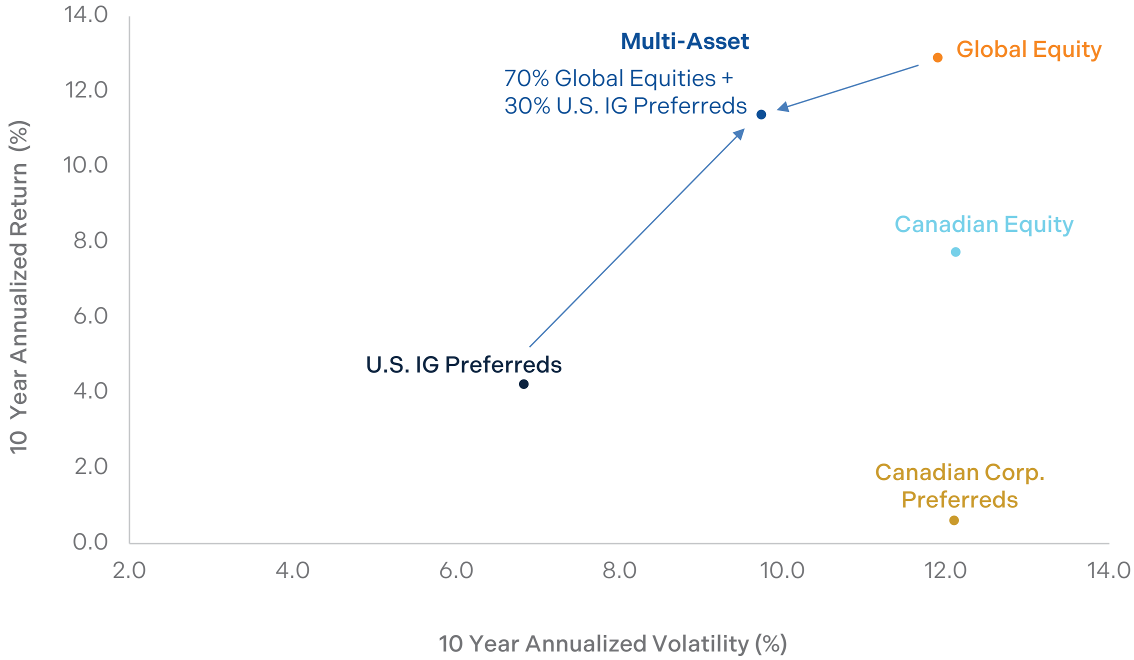


Source: Bloomberg. Trailing 12-Month Earnings per Share, as at December 30, 2022. Earnings rebased to $100 at January 01, 1999

Diversified Portfolio

A well-diversified portfolio can help investors to weather through different market cycles. Depending on the investor's risk tolerance level, a strategic asset allocation between asset classes, sectors, investment strategies and geographical regions should be able to reduce the overall portfolio volatility while providing investors with long term growth opportunities. The chart below demonstrates that combining global equities with U.S. investment grade preferred shares, as an example of a diversified multi-asset portfolio, generates a very attractive total return but also lowers the equity risk profile, as expressed through lower volatility.

Multi-Asset: Higher Risk-Adjusted Returns



Source: Morningstar Direct, as at December 31, 2022, Multi-Asset is based on quarterly rebalancing and is represented by: 70% MSCI World TR Index and 30% ICE BofA 8% Constrained Core West Preferred & Jr Subordinated Securities Index; U.S. Investment Grade Preferreds– ICE BofA 8% Constrained Core West Preferred & Jr Subordinated Securities Index; Canadian Equity – S&P/TSX Composite TR Index; Global Equity – MSCI World TR Index; Canadian Corporate Preferreds – S&P/TSX Preferred TR Index; Canadian Corporate Bonds – ICE BofA Canada Corporate Index.

Covered Call Strategies

By using a covered call strategy, portfolios can draw on three main sources of potential total return:

1. Capital appreciation of the underlying equities in the portfolio
2. Dividend income from the portfolio
3. **Premiums earned from writing call options**

Market volatility can surge during recessionary periods, and this will result in an increase in option premiums. The increased premium collected through option writing should result in increased cash flows and provide additional downside protection for the client's portfolio. Recessionary markets can be an ideal environment for covered call strategies.

Brompton's Approach

Brompton offers a variety of Dividend Growth products including Brompton Global Dividend Growth ETF (BDIV), Brompton European Dividend Growth ETF (EDGF), Dividend Growth Split Corp. (DGS, DGS.PR.A), and Global Dividend Growth Split Corp. (GDV, GDV.PR.A), which are all designed to invest in well-diversified portfolios of high-quality, large capitalization dividend growth equities.

Brompton Global Healthcare Income & Growth ETF (HIG, HIG.U) provides diversified exposure to the global healthcare sector. In addition, we actively manage the healthcare weighting across our global dividend portfolios (BDIV, GDV, EDGF). We prefer to invest in healthcare companies that are market leaders with solid commercial product pipelines, versus early-stage healthcare companies. We believe this strategy provides better risk-adjusted returns, particularly in an inflationary environment. In addition, a diversified product pipeline mitigates risks associated with patent cliffs. We actively manage the sub-sector weightings within healthcare which is tilted towards companies with long/durable product cycles and lower research and development intensity.

Brompton Enhanced Multi-Asset Income ETF (BMAX) offers a unique, diversified multi-asset investment by combining covered call equity ETFs, U.S. Investment Grade Preferred Shares and Brompton Split Corp. Preferred Shares. The equity ETFs included in the BMAX portfolio are globally diversified across major developed markets. Investors may benefit from the long-term growth potential of high-quality companies and reduce the concentration risk of investing in one single region. Brompton's equity ETFs also utilize covered call writing strategies which can further reduce overall portfolio volatility and provide enhanced income for investors. This unique approach to a multi-asset solution provides investors with attractive income as well as asset class and geographic diversification. BMAX provides investors with an efficient way to access a portfolio designed for various market conditions.

We also use an **actively managed call writing overlay** to harvest volatility risk premium which enhances risk-adjusted returns for all of our equity ETFs.

[1] Returns are based on the S&P 500 Total Return, best days are those with the highest daily returns between Jan 1, 2002 and Dec 31, 2021. https://www.cnbc.com/2022/03/09/you-may-miss-the-markets-best-days-if-you-sell-amid-high-volatility.html.

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Investor Relations
PHONE 416.642.6000
TOLL FREE 1.866.642.6001
FAX 416.642.6001
info@bromptongroup.com
www.bromptongroup.com

Address
Bay Wellington Tower,
Brookfield Place
181 Bay Street
Suite 2930, Box 793
Toronto, Ontario M5J 2T3